Economic Update — Thursday, 25 October 2018

Mini Budget is a Big Deal

The past few years have been rocky for neighbouring South Africa (RSA/SA) so much so that by the end of last year we witnessed the impeachment of yet another president since the inception of democratic rule. The scandalous circumstances which led to said impeachment turned out to be far more wide spread than previously imagined with new revelations coming to light almost on a daily basis. One such revelation lead to the resignation of a Finance Minister just weeks before the delivery of the 2018 medium term budget policy statement (MTBPS), making Mr. Tito Mboweni the fifth individual to assume that office in just three years.

The new Minister of Finance re-enters public service at a time when SA's fiscal stability is under strain leaving very little room for policy adjustments. Government spending cannot rise to the aid of the economy as that would result in a wider deficit and further indebtedness. Avenues for raising revenue are almost tapped out as further tax increases could end up stifling rather than boosting national income. At this particular juncture in SA's history formulating fiscal policy is best described as "a balancing act" or "walking a tight rope".

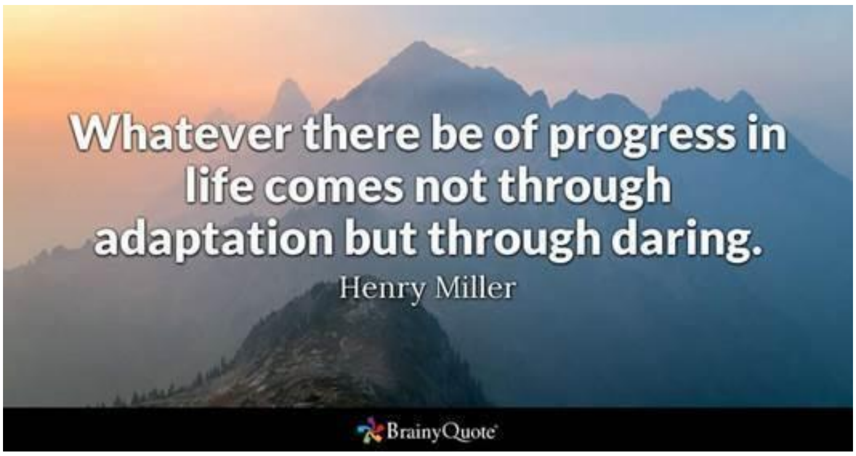
Feathers were ruffled among rich and poor of South Africa earlier in the year with the introduction of a new tax bracket as well as a one percent increase in VAT. The MTBPS might serve to appease the masses as it not only reduces the likelihood of another income tax hike but it also included three additional items (white bread flour, cake flour & sanitary pads) to the basket of zero rated consumer goods. In February it was projected that the one percent VAT increase would generate R23 billion in revenue. Eight months down the line RSA's treasury estimates a shortfall of R27.4 billion, R9 billion of which results from VAT refunds. As taxes increase so does the tendency for noncompliance; the R7.4 billion shortfall in corporate and personal income tax during the current budget year is probably as sign of declining tax buoyancy. Revenue growth should average 7.8% over the next three years, 1.1% lower than the five year average. The MTBPS also projects revenue to at just over a quarter of GDP for each of the three years during the medium term bringing the total to R1.71 trillion by 2021.

Fiscal prudence remains at the core of this balancing act. While medium term expenditure estimates have been revised upwards since February when the main budget was delivered, these increases have been rather modest and seem to have been capped at a third of GDP over the next three years. On average expenditure is expected to grow by 8.0% in the medium term ending 2021 which is lower than the current ten year average which is over 11%. In line with President Ramaphosa's stimulus intervention spending will target the reduction of the 27.2% unemployment rate and the alleviation of poverty. As such more than half of the total consolidated expenditure (R1,95 trillion by 2021) will be put towards social development. Infrastructure development also ranks high among the budget's priorities and the government will seek partnerships with private entities to raise the necessary capital. An emphasis has been placed on own-financing in this budget which implies that various public organisations will be expected to raise funds from their own operations to cover future costs. Economic stimulus is also made possible despite fiscal consolidation by dipping into the state's contingency reserve and repatriating expected and declared unspent funds which amounts to R17.5 billion.

Consequently the deficit will expand to R202 billion, R226 billion and R246 billion in 2019, 2020 and 2021 respectively. This implies a 30bp increase in the deficit to GDP ratio from an average of 3.6% projected in February. The achievement of a 3.9% ratio over the medium term depends largely on the success of the stimulus intervention and various strategies to gear towards the improvement of export receipts which are expected to trigger nominal GDP growth of up to 9.4% in 2021.

First among three main risks to the containment of expenditure is mismanagement of state owned enterprises (SOE's) whose debt has been guaranteed by the government and, if called upon, could push the total debt burden as high as 70% of GDP. An additional five billion rand have been allotted to South African Airways in this financial year while SA Express Airways and SA Post Office will receive a further R1.25 billion and R2.95 billion as well. The second major threat to fiscal stability is the rising cost of debt courtesy of the depreciation of the ZAR and waning investor confidence towards emerging markets which can only be worsened if Moody's drops SA's sovereign credit rating one notch lower to sub-investment grade. Debt service costs are rising at a growth rate of 10.5% which is quite concerning as it is the most inflexible area of spending. Finally, the wage bill continues to present a challenge. The government has done well to slow down the growth rate of employee compensation since its last high at 19.4% in 2013 but over the last twenty years wages have stubbornly laid claim to at least 30% of total expenditure leaving an average of only 11% for development spending purposes.

The South African economy is in need of rescue and even though most developmental financing has been sourced locally, the R100 billion that president intends on raising will require massive foreign inflows. As such this MTBPS and the 2019 budget will have to convince ratings agencies that the deficit ratio will not exceed 4.0% and debt to GDP will remain below 60%. Ratios in excess of the stated figures would imply that SA would be in fiscal distress i.e. unable to meet their debt obligations. It is doubtful that Moody's would downgrade the country's sovereign debt to sub-investment grade ahead of the main budget in February, however, the mere anxiety has induced a currency depreciation and an a rise in bond yields since the 2018 MTBPS. Now more than ever confidence needs to be restored in the South African economy in order to attract both local and international investment.

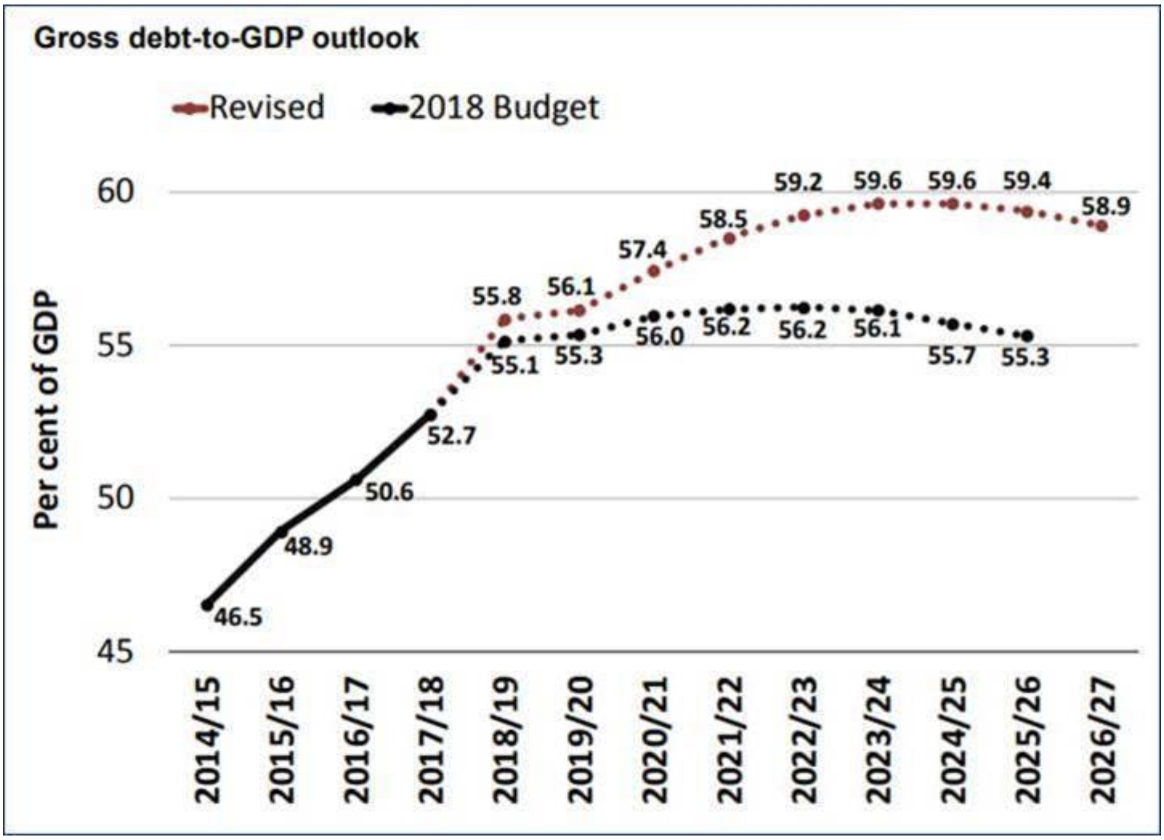


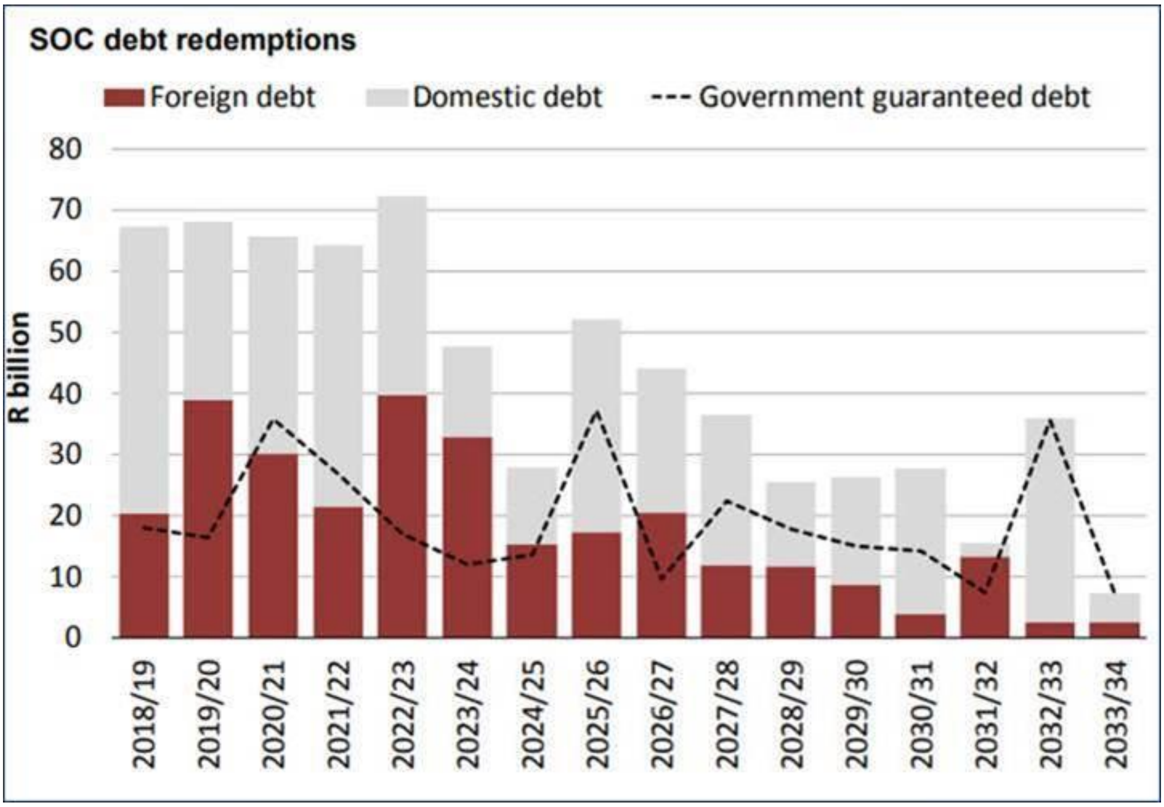
Stats of the Day

Budget vs MTPS													
	Outcome	Estimate			Forecast								
ZAR, mil	2016/17	2017/18			2018/19			2019/20			2020/21		
	MTPS	Budget	MTPS	Difference	Budget	MTPS	Difference	Budget	MTPS	Difference	Budget	MTPS	Difference
Total Revenue	1,297,295	1,353,629	1,359,981	6,352.0	1,490,716	1,467,199	(23,517.0)	1,609,669	1,582,023	(27,646.0)	1,736,902	1,705,123	(31,779.0)
% ch	6.2	4.3	4.8	0.5	10.1	7.9	(2.2)	8.0	7.8	(0.2)	7.9	7.8	(0.1)
% of GDP	27.9	28.8	27.5	(1.3)	29.7	27.6	(2.1)	29.9	27.6	(2.2)	29.9	27.6	(2.3)
Despite income tax & VAT hikes revenue growth is forecast to decline over the medium term													
Total Expenditure	1,445,205	1,557,959	1,549,538	(8,421.0)	1,671,190	1,669,211	(1,979.0)	1,802,955	1,808,417	5,462.0	1,941,948	1,950,880	8,932.0
% ch	5.9	7.8	7.2	(0.6)	7.3	7.7	0.5	7.9	8.3	0.5	7.7	7.9	0.2
% of GDP	31.1	33.2	31.3	(1.8)	33.3	31.4	(1.9)	33.4	31.6	(1.9)	33.4	31.6	(1.8)
Consolidation remains "the anchor" of fiscal stability. Operational spending and transfers & susidies represent bulk of expenditure													
Deficit	(147,910)	(204,330)	(189,557)	14,773.0	(180,474)	(202,012)	(21,538.0)	(193,286)	(226,394)	(33,108.0)	(205,046)	(245,757)	(40,711.0)
% of GDP	-3.2	-4.3	-3.8	0.5	-3.6	-3.8	(0.2)	-3.6	-4.0	(0.4)	-3.5	-4.0	(0.5)
Deficit remains above 3.5% comfort level. Mainly driven by rising debt service costs													
Net Loan Debt	2,006,247	2,284,711	2,264,500	(20,211.0)	2,526,537	2,546,300	19,763.0	2,768,218	2,823,000	54,782.0	3,030,449	3,133,700	103,251.0
% of GDP	43.1	48.6	45.8	(2.9)	50.3	47.9	(2.4)	51.4	49.3	(2.0)	52.2	50.8	(1.4)
Guanrantees, etc	945,456	965,241	965,241	-	1,034,996	1,034,996	-	1,097,945	1,097,945	-	1,183,048	1,183,048	-
% of GDP	20.3	20.5	19.5	(1.0)	20.6	19.5	(1.1)	20.4	19.2	(1.2)	20.4	19.2	(1.2)
Total Debt	2,951,703	3,249,952	3,229,741	(20,211.0)	3,561,533	3,581,296	19,763.0	3,866,163	3,920,945	54,782.0	4,213,497	4,316,748	103,251.0
% of GDP	63.5	69.2	65.3	(3.9)	70.9	67.4	(3.5)	71.7	68.5	(3.2)	72.5	70.0	(2.5)
Dangerously close to fiscal distress. Gross debt projected at 59.6% of GDP in next five years													
Nominal GDP	4,651,785	4,699,381	4,949,051	249,670.0	5,025,379	5,317,234	291,855.0	5,390,083	5,724,062	333,979.0	5,808,342	6,167,247	358,905.0
% ch	6.9	6.6	6.4	(0.2)	6.9	7.4	0.5	8.2	9.1	0.9	8.5	9.4	0.9
Rising inflation fluffing up nominal GDP. Forecast hinges on success of stimulus programme and improvement in international trade													
Source: Capricorn Asset Management, 2018													

Republic of South Africa Medium Term Budget Charts & Tables

Consolidated government fiscal framework					
	2017/18	2018/19	2019/20	2020/21	2021/22
R billion/percentage of GDP	Outcome	Revised	Medium-term estimates		
Revenue	1 360.0	1 467.2	1 582.0	1 705.1	1 840.0
	28.8%	29.1%	29.2%	29.2%	29.3%
Expenditure	1 549.5	1 669.2	1 808.4	1 950.9	2 091.1
	32.8%	33.1%	33.4%	33.4%	33.2%
Budget balance	-189.6	-202.0	-226.4	-245.8	-251.1
	-4.0%	-4.0%	-4.2%	-4.2%	-4.0%
Total gross loan debt	2 489.7	2 817.7	3 038.4	3 349.6	3 679.9
	52.7%	55.8%	56.1%	57.4%	58.5%
Source: National Treasury					





Source: Medium Term Budget Policy Statement, National Treasury of South Africa, 2018

Data Releases

Local Time	Country	Indicator Name	Period
11:30	South Africa	PPI MM	Sep
11:30	South Africa	PPI YY	Sep
13:45	Euro Zone	ECB Refinancing Rate	Oct
13:45	Euro Zone	ECB Deposit Rate	Oct
14:30	United States	Durable Goods	Sep
14:30	United States	Durables Ex-Transport	Sep
14:30	United States	Durables Ex-Defense MM	Sep
14:30	United States	Nondefe Cap Ex-Air	Sep
14:30	United States	Corn Export Sales New	15 Oct, w/e
14:30	United States	Corn Export Sales Net	15 Oct, w/e
14:30	United States	Corn Exp Sale Next Yr Net	15 Oct, w/e
14:30	United States	Corn Exp Sales Net Total	15 Oct, w/e
14:30	United States	Soybean Export Sales New	15 Oct, w/e
14:30	United States	Soybean Export Sales Net	15 Oct, w/e
14:30	United States	Soybean Exp Sale Next Yr Net	15 Oct, w/e
14:30	United States	Soybean Exp Sale Net Total	15 Oct, w/e
14:30	United States	Soybeanmeal Exp Sale Net	15 Oct, w/e
14:30	United States	Soymeal Exp Sls Next Yr Net	15 Oct, w/e
14:30	United States	Soybn Meal Exp Sls Net Total	15 Oct, w/e
14:30	United States	Soybeanoil Exp Sales Net	15 Oct, w/e
14:30	United States	Soybn Oil Exp Sls Nxt Yr Net	15 Oct, w/e
14:30	United States	Soybn Oil Exp Sls Net Total	15 Oct, w/e
14:30	United States	Wheat Export Sales New	15 Oct, w/e
14:30	United States	Wheat Export Sales Net	15 Oct, w/e
14:30	United States	Wheat Exp Sale Next Yr Net	15 Oct, w/e
14:30	United States	Wheat Exp Sale Net Total	15 Oct, w/e
14:30	United States	Beef Export Sales New	15 Oct, w/e
14:30	United States	Beef Export Sales Net	15 Oct, w/e
14:30	United States	Up Cotton Exp Sales New	15 Oct, w/e
14:30	United States	Up Cotton Exp Sales Net	15 Oct, w/e
14:30	United States	US Pork Export Sales New	15 Oct, w/e
14:30	United States	US Pork Export Sales Net	15 Oct, w/e
14:30	United States	Adv Goods Trade Balance	Sep
14:30	United States	Wholesale Inventories Adv	Sep
14:30	United States	Retail Inventories Ex-Auto Adv	Sep
14:30	United States	Initial Jobless Claims	15 Oct, w/e
14:30	United States	Jobless Claims 4-Wk Avg	15 Oct, w/e
14:30	United States	Continued Jobless Claims	8 Oct, w/e
16:00	United States	Pending Homes Index	Sep
16:00	United States	Pending Sales Change MM	Sep
17:00	United States	KC Fed Manufacturing	Oct
17:00	United States	KC Fed Composite Index	Oct

Source: Thomson Reuters

Market Overview

Money Market		Change	Latest
3 months	→	0.00%	7.03%
6 months	→	0.00%	7.65%
9 months	↓	-0.02%	7.93%
12 months	↓	-0.04%	8.33%
Bonds		Change	Latest
GC21 (R208 : 7.65%)	↓	-0.07%	8.51%
GC24 (R186 : 9.05%)	↓	-0.10%	10.35%
GC27 (R186 : 9.05%)	↓	-0.10%	10.45%
GC30 (R2030 : 9.48%)	↓	-0.09%	10.98%
GC32 (R213 : 9.56%)	↓	-0.10%	11.29%
GC35 (R209 : 9.76%)	↓	-0.09%	11.26%
GC37 (R2033 : 9.68%)	↓	-0.09%	11.61%
Commodities		%Change	Latest
Gold	↑	0.03%	$ 1,230.73
Platinum	↓	-0.25%	$ 830.60
Copper	→	0.00%	$ 6,196.00
Brent Crude	↓	-0.08%	$ 75.62
Main Indices		%Change	Latest
NSX (Delayed)	↑	0.12%	1212.80
JSE All Share	↓	-0.94%	50,687.38
S&P 500	↓	-0.55%	2,740.69
FTSE 100	↑	0.79%	7,010.10
Hangseng	↓	-0.38%	25,249.78
DAX	↑	0.39%	11,317.99
JSE Sectors		%Change	Latest
Financials	↑	0.66%	15,268.44
Resources	↓	-2.36%	39,029.20
Industrials	↓	-1.03%	61,369.70
Forex		%Change	Latest
N$/US Dollar	↓	-0.51%	14.1845
N$/Pound	↓	-1.08%	18.3083
N$/Euro	↓	-1.09%	16.1742
US Dollar/ Euro	↓	-0.59%	1.1403
Namibia Monthly Data		Latest	Previous
Namibia Inflation (Sep 18)		4.8	4.4
Bank Prime		10.50	10.50
BoN Repo Rate		6.75	6.75

Source: Bloomberg

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